

TENNESSEE GENERAL ASSEMBLY  
FISCAL REVIEW COMMITTEE



FISCAL MEMORANDUM

HB 2228 – SB 2402

March 28, 2016

**SUMMARY OF ORIGINAL BILL:** Authorizes a foreign insurer (from a different state) or an alien insurer (from a different country) to become a domestic captive insurance company. Requires that such redomestication is authorized under the applicable laws in which the foreign or alien insurer is currently domesticated, and evidence to be provided that the applicable regulatory authority of its domicile consents to such redomestication. Any foreign or alien company which meets such requirements may file with the Secretary of State its articles of association, charter, or other organizational documents together with appropriate amendments to bring all such documents into compliance with the laws of this state with an approval letter signed by the Commissioner of the Department of Commerce and Insurance (CIS). Upon an applicant paying all applicable fees, the Secretary of State is required to issue an acknowledgement letter and is authorized to charge the applicant insurer a fee to cover the cost of domestication. The applicant is required to file a copy of the acknowledgement letter with the Commissioner and upon doing so will be issued a license as a domestic captive insurance company.

Establishes that any company redomesticating under this legislation is only liable for premium taxes pursuant to Tenn. Code Ann. § 56-13-114. Any company that redomesticates after July 1 of a year is only subject to one-half of the minimum aggregate tax specified in § 56-13-114(c) in its first year after redomestication. Authorizes an alien company redomesticating under the provisions of this legislation to, in its first or second year of operations, elect to forego the payment of premium taxes; however, any company that makes the decision to surrender its license or redomesticates to another jurisdiction within five years of redomesticating into this state shall immediately pay a tax amount equal to the foregone premium tax plus ten percent per annum from the date the foregone premium tax would have otherwise been due. Establishes that this legislation shall not restrict the ability of an insurance company to undergo a merger, consolidation, or transfer of assets or liabilities, or utilize any other means permitted by law to affect the transfer of operations of a foreign or alien insurance company to this state.

Establishes legal protections for protected cells within a protected cell captive insurance company by requiring that any legal action specify the exact cell or cells which are party to a suit. Establishes that any cell that is erroneously named a party to a suit shall have a right to prompt dismissal of legal action. Prohibits the assets of one cell from being seized to satisfy the obligations of or judgment against any other protected cell. Provides confidentiality to the document or papers of any individual cell.

Establishes that each captive insurance company and each protected cell of a captive insurance company, that insures only the risks of the captive insurance company's or protected cell's

owners, affiliated companies or controlled unaffiliated business, shall be treated as a pure captive insurance company for the purpose of calculating ad valorem taxes.

Establishes that owners of a captive insurance company who redomesticate a company to this state by December 31, 2018 shall not be liable for any unreported taxes due pursuant to the self-procurement tax otherwise placed on alien and foreign companies providing insurance in Tennessee, provided that a policy or contract of insurance procured from the company after its redomestication is substantially similar to the policy or contract of insurance procured before the redomestication.

#### FISCAL IMPACT OF ORIGINAL BILL:

Increase State Revenue –

\$6,500/FY16-17 and Subsequent Years/CIS

\$400/FY16-17 and Subsequent Years/Secretary of State

\$183,800/FY17-18/General Fund

\$416,600/FY18-19/General Fund

Exceeds \$692,000/FY19-20 and Subsequent Years/General Fund

Foregone State Revenue - Exceeds \$46,000/FY16-17 and Subsequent Years/General Fund

#### IMPACT TO COMMERCE OF ORIGINAL BILL:

Increase Business Revenue - Exceeds \$40,000,000/FY16-17 and Subsequent Years

Increase Business Expenditures – Less Than \$40,000,000/FY16-17 and Subsequent Years

Commerce Impact - Recurring business expenditures will be reduced as a result of lower premium tax rates made available through self-insurance. Any such recurring reduction in business expenditures would be offset by other one-time increases in business expenditures for the cost incurred by businesses in relocating to Tennessee. The net reduction in business expenditures for businesses impacted by the bill is unknown, but is reasonably estimated to exceed \$100,000 per year. Any net impact to business revenue cannot be quantified because such impact is dependent upon multiple unknown factors.

Jobs Impact - The net impact to Tennessee jobs is difficult to determine because some companies may relocate to Tennessee as a result of this bill and some jobs may transfer within Tennessee from one sector of the insurance industry to another. The net impact of Tennessee jobs is not quantifiable, but is considered positive.

**SUMMARY OF AMENDMENT (014865):** Deletes and replaces language in the original bill such that substantive changes include: (1) deletes Section 3 of the original bill which established that each captive insurance company and each protected cell of a captive insurance company, for the purposes of calculating ad valorem taxes, should be treated as a pure captive insurance company; (2) changes the date from March 1 to March 15 of each year, by which captive insurance companies in this state are required to pay taxes on all premiums collected; (3)

creates additional requirements of alien and foreign insurers in order to forego liability of taxes for any unreported taxes due pursuant to the self-procurement tax otherwise placed on alien and foreign companies providing insurance in Tennessee; and (4) requires a captive insurance company organized as a risk retention group to submit a report of its financial condition prior to March 1 of each year.

## **FISCAL IMPACT OF BILL WITH PROPOSED AMENDMENT:**

### **Unchanged from the original fiscal note.**

Assumptions for the bill as amended:

- This legislation will result in additional insurance companies in the form of foreign and alien insurers becoming licensed as captive insurance companies in this state.
- CIS estimates that this legislation will incentivize four additional foreign or alien insurers each year to redomesticate to Tennessee and become licensed as captive insurance companies.
- The following fees are applicable to new captive insurance companies in this state and are collected by CIS: application fee: \$675; certificate of authority: \$440; and annual statement filing fee: \$515.
- In FY16-17 and subsequent years, CIS will collect additional fee revenue of \$6,520 [4 x (\$675 + \$440 + \$515)]. Revenue from filing fees will remain with CIS.
- Each captive will file a charter with the Secretary of State. Filing a charter is accompanied by a fee of \$100.
- The Secretary of State will collect additional charter fee revenue of \$400 (4 x \$100). Ninety-seven percent (0.97) goes to the general fund x three percent (0.03) remains with the Secretary of State's Office.
- In FY16-17 and subsequent years, additional General Fund revenue of \$388 (\$400 x 0.97) and revenue to the Secretary of State's Office of \$12 (\$400 x 0.03).
- In FY16-17, the average gross premium collection of each captive company is estimated to be \$10,000,000. Total new premiums collected by these four (4) captive companies is estimated to be \$40,000,000 (4 x \$10,000,000).
- Based on information provided by the Captive Insurance Section, the average premium tax collections growth rate in the first year is 14.9 percent (0.149). The 2nd and 3rd year compound annual growth rate for premium tax collections is 45.5 percent (0.455) and 72.1 percent (0.721), respectively. This percentage takes into account reinsurance premium tax collections. Reinsurance is a popular option for captives as it allows, among other financial benefits, to lower the amount of capital required to self-insure, subsequently releasing capital for other financing, investing, and operating activities. Reinsurance premiums, as applicable to current state law, are taxed at a lower rate.
- The annual gross premium tax is 4 percent (0.04) on the first \$20,000,000 premiums collected and 3 percent (0.03) on all premiums collected over \$20,000,000. It is

reasonably assumed that not one of these four new captive companies will collect total premiums surpassing \$20,000,000 in any of the first three (3) years upon creation.

- Section 1 (g)(3) of this legislation authorizes an alien captive insurance company which redomesticates to this state and is in its first or second year of operations to forego the payment of premium taxes in the first or second year following redomestication. It is assumed that each company that redomesticates to this state will elect to forego premium tax payments in its first year.
- It is estimated that each year one alien captive company would have redomesticated to Tennessee in the absence of this legislation. The premium tax which these companies would have been subject to in the first year or second year of operation upon redomesticating will not be collected and instead will be foregone revenue.
- This legislation establishes that owners of a captive insurance company who redomesticate a company to this state by December 31, 2018 shall not be liable for any unreported taxes due pursuant to the self-procurement tax otherwise placed on alien and foreign companies providing insurance in Tennessee, provided that a policy or contract of insurance procured from the company after its redomestication is substantially similar to the policy or contract of insurance procured before the redomestication. This legislations will likely result in an increase in foregone revenue from self-procurement taxes that would have otherwise been collected in absence of this legislation.
- Foregone revenue in FY16-17 and subsequent years exceeding \$45,960  $[(\$10,000,000 \times 1.149) \times .004]$ . Premium tax collections in FY16-17 are estimated to be \$0.
- Premium tax collections in FY17-18 are estimated to be \$183,840  $[(\$40,000,000 \times 1.149) \times .004]$ .
- Premium tax collections in FY18-19 are estimated to be \$416,640  $[(\$40,000,000 \times 1.455) \times .004] + [(\$40,000,000 \times 1.149) \times .004]$
- Premium tax collections in FY19-18 and recurring years exceeding \$692,000  $\{[(\$40,000,000 \times 1.721) \times .004] + [(\$40,000,000 \times 1.455) \times .004] + [(\$40,000,000 \times 1.149) \times .004]\}$ .

## **IMPACT TO COMMERCE WITH PROPOSED AMENDMENT:**

### **Unchanged from the original fiscal note.**

Assumptions for the bill as amended:

- The new captive companies are estimated to collect premium revenue in an amount that exceeds \$40,000,000 statewide. Any business expenditures are estimated to be less than the amount of revenue collected for the companies to remain solvent.
- Impacted businesses may benefit as a result of having reduced premium payments. Due to numerous unknown factors, any reduction to current business expenditures is unable to be determined. For companies that transfer employees from out-of-state, any decrease in expenditures attributable to reduced premium payments will be partially offset by new business expenditures incurred for the cost of relocating to Tennessee. It is assumed that

the impacted businesses would not relocate to Tennessee if the cost of relocating exceeded the expenditure reductions from paying lower premium tax rates.

- Any net impact to business revenue, and thus net income for businesses, cannot be determined because such impacts are dependent upon multiple unknown factors such as the service rate charges applicable to insurance plans offered by newly created captive companies, the extent of competition that would exist currently from other Tennessee-domiciled businesses, and the extent that a market entrant would dilute market share for any particular industry.
- Secondary impacts to commerce may include increased consulting fees to licensed attorneys, CPAs and other professions within the state. Due to multiple unknown factors, this impact is unable to be determined, but is considered positive.

### **CERTIFICATION:**

The information contained herein is true and correct to the best of my knowledge.

A handwritten signature in blue ink that reads "Krista M. Lee". The signature is written in a cursive, flowing style.

Krista M. Lee, Executive Director

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